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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 408

CLOVER SPLINT COAL CO., INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court of the United States (R. 62a–64a) are unreported. The opinion of the United States Circuit Court of Appeals for the Third Circuit (R. 70–73) is reported in 143 F. (2d) 108.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 6, 1944 (R. 73–74). The petition for a writ of certiorari was filed on August 28, 1944. The jurisdiction of this Court

is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The petitioner failed to elect to take coal percentage depletion in 1934 and thereby elected negatively to take depletion deductions in that and subsequent years on the cost basis under Section 114 (b) (4) of the Revenue Act of 1934.

The question is whether the petitioner was entitled to a new election for the years 1938 and 1939 either under Section 114 (b) (4) of the Revenue Act of 1936 or under Section 114 (b) (4) of the Revenue Act of 1938.

STATUTES AND REGULATIONS INVOLVED

These are found in the Appendix, *infra,* pp. 11–16.

STATEMENT

So far as material here, the facts found by the Tax Court may be summarized as follows:

On February 26, 1927, the petitioner, a West Virginia corporation, acquired a coal mining lease in Harlan County, Kentucky, at no cost, and has at all times since remained the lessee thereunder (R. 62a). In its returns for 1938 and 1939 the petitioner claimed a deduction on account of percentage depletion in the amounts of $37,700.76 and $34,922.63, respectively (R. 62a).

The petitioner did not in its return for the years 1934 and 1935 indicate its election to compute deductions for depletion on the percentage basis, but it did make a statement in its return for 1936 to the effect that it elected to have such allowance "computed with regard to percentage depletion" (R. 63a).

It further appears from the record that the petitioner had gross, but no net, income in 1934 and 1935 (R. 25a, 41a), and it is stated in the opinion of the Circuit Court of Appeals that the petitioner's return for 1936 disclosed a small net income (R. 72).

The Commissioner disallowed the claim (R. 14a, 16a–17a). He accordingly determined deficiencies for the taxable years 1938 and 1939 in the amounts of $6,528.51 and $6,064.60, respectively, which resulted primarily from the disallowance of such claims (R. 15a–16a, 20a–21a). The Tax Court sustained the Commissioner's determination (R. 64a) and the Circuit Court of Appeals affirmed the Tax Court's decision (R. 73–74).

ARGUMENT

1. The decision below is not in conflict with any decision of this Court or of an inferior appellate court. The petitioner does not claim that there is a conflict in the ordinary sense of the term, but only in that the "liberal" construction of a portion of the statute, to which the court below

is said to have resorted in arriving at its conclusion here, is inconsistent with the "strict" construction which this Court is said to have placed upon other portions of the statute in arriving at the conclusions it did in the cases of *Mother Lode Co.* v. *Commissioner,* 317 U. S. 222, and *Riley Co.* v. *Commissioner,* 311 U. S. 55.

Thus the petitioner contends that if, instead of "liberally" construing the provisions of Section 114 (b) (4) which were added thereto by the 1936 Act (Appendix, *infra,* pp. 12–13), the court below had construed them "literally," as this Court is said to have construed the other provisions of the section in both of the cited cases, the court below would necessarily have reached the conclusion that the petitioner was entitled to a new election to take percentage depletion in 1936 under the 1936 Act, even though it may, in view of the decision of this Court in the *Mother Lode* case, have been required, but failed, to make such election in 1934 under the 1934 Act.

This contention presents nothing for review.

2. There is, moreover, no basis for the petitioner's contention that the court below improperly construed Section 114 (b) (4) of the Revenue Act of 1936 as requiring the taxpayer to adhere to the election it negatively made in 1934 under Section 114 (b) (4) of the 1934 Act (Appendix, *infra,* pp. 11–12) by its failure then to elect percentage depletion.

By Section 114 (b) (4) of the Revenue Act of 1932, c. 209, 47 Stat. 169, Congress inaugurated a new policy regarding the basis for deductions on account of depletion in the case of metal, coal, and sulphur mines. Under that section, a taxpayer was privileged in the years 1932 and 1933 to have the greater of (1) the percentage depletion allowance, or (2) an allowance computed on the adjusted basis provided by Section 113 (b), commonly referred to as the cost basis. In its taxable return for 1933, however, the petitioner was required to make an election for 1934 which was binding upon it for all subsequent years. The only election required to be made expressly was the election to take the deduction on the percentage basis. If it failed to make such election it was deemed to have elected to take the deduction on the cost basis. S. Rep. No. 665, 72d Cong., 1st Sess., p. 30 (1939–1 Cum. Bull. (Part 2) 496, 518); also Article 225 of Treasury Regulations 77, promulgated under the 1932 Act.

The 1934 Act, however, required a new election for 1934 and all subsequent years, so that an election to take percentage depletion made for the first time in 1935 was held to be *functus officio* where the taxpayer in 1934 had had items of gross income, even though he had no net income. For in the *Mother Lode* case this Court held that the election to take percentage depletion must, in such circumstances, have been made in 1934, and that

failure then to make such election constituted an election to take depletion thereafter without reference to percentage depletion. Hence, unless the 1936 Act gave the petitioner a new election, the 1934 election of cost depletion, negatively made by the petitioner's failure affirmatively to elect percentage depletion, would control.

Section 114 (b) (4) of the 1936 Act is identical with the provisions of Section 114 (b) (4) of the 1934 Act, except that the following sentence was added to the section by the 1936 Act:

> The above right of election shall be subject to the qualification that this paragraph shall, for the purpose of determining whether the method of computing the depletion allowance follows the property, be considered a continuation of section 114 (b) (4) of the Revenue Act of 1934, and as giving no new election in cases where such section would, if applied, give no new election.

This sentence, in identical language, also appears in Section 114 (b) (4) of the 1938 Act, which likewise is otherwise identical with Section 114 (b) (4) of the 1934 Act. The same is true of Section 114 (b) (4) of the Internal Revenue Code.

It is thus at once apparent that, but for the addition of this sentence, a new election would have been permitted under both the 1936 and 1938 Acts. Cf. *Mother Lode Co.* v. *Commissioner, supra.* The question then is whether the

provision of the added sentence prohibits a new election in any taxable year to which either the 1936 or the 1938 Act applies, where it appears that an election should have been made in a prior year to which the 1934 Act was applicable. We submit that the added sentence does prohibit a new election in such a case.

The obvious purpose of Congress in enacting Section 114 (b) (4) of the 1934 Act was to provide a method of computing depletion allowance which would follow the property in all years to which that Act might be applicable, so long, but only so long, as it remained in the hands of the taxpayer who was required to make the election. Moreover, such an election was to be made in the first year to which the Act applied in which an election could be made thereunder. In the case at bar, this was the year 1934.

It was in order to carry out that policy thereafter, regardless of the enactment of new revenue acts, which normally became effective only in the respective years of their enactment, that Congress added the new sentence to Section 114 (b) (4) in the Revenue Act of 1936, and that it later included the sentence in Sections 114 (b) (4) of the 1938 Act and the Internal Revenue Code. We do not see how the language used could be clearer than it is to carry this purpose into effect; and so the court below appears to have thought when it said that this was the

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common sense construction of the statute. Indeed, in the case of *Tonopah Mining Co.* v. *Commissioner,* 127 F. (2d) 239, 244, it had already concluded that any other construction would be absurd.

The petitioner does not say what its view of the purpose and meaning of the added language is. But, if it is not to deny a new election to a taxpayer who continues in ownership or possession of the property, it could only be to deny a new election to a taxpayer who initiates ownership in a taxable year to which either the 1936 or the 1938 Act or the Internal Revenue Code is applicable. Although not made here, this contention was made by the petitioner below. It was rejected by the court below on the authority of the *Tonopah* case, as has already been indicated, because the result which its acceptance would achieve was absurd.

Moreover, to construe the added language as inapplicable to a continuing owner is but to require a disregard of the addition in its entirety; for the continuing owner would, as has been pointed out, have been permitted a new election in 1936 under the 1936 Act if the sentence in question had not been added thereto.

We submit that the petitioner's contention is not deserving of this Court's consideration.

3. In any event, the question here presented is moot. The petitioner cannot prevail even if it was permitted to make a new election under Section 114 (b) (4) of the 1936 Act. For, if it was permitted, it was likewise required to do so. And, if it was required to make a new election under Section 114 (b) (4) of the 1936 Act for the years 1936 and 1937, it was likewise required to make a new election under the identical language of Sections 114 (b) (4) of the 1938 Act and the Internal Revenue Code for the years 1938 and 1939, respectively. The election in 1936, upon which it relies, would not be sufficient. But the record does not disclose that the petitioner made such an election in 1938, although it does disclose, and there is no denial here, that it had gross income in that year (R. 12a–16a).

4. Furthermore, the question which the petitioner here presents is no longer of any importance, for by Section 145 of the Revenue Act of 1942, c. 619, 56 Stat. 798, Section 114 (b) (4) of the Internal Revenue Code was amended so as to permit an election to be made to take percentage depletion each year for any taxable year beginning after December 31, 1941.

CONCLUSION

There is no conflict. The contentions advanced are not meritorious. As concerns this petitioner,

the question is moot, and it is in any event of no importance in view of the 1942 amendment of the statute. For these reasons, the petition should be denied.

Respectfully submitted.

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SEPTEMBER 1944.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(4) *Percentage depletion for coal and metal mines and sulphur.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and

the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(4) *Percentage depletion for coal and metal mines and sulphur.*—The allowance for depletion under section 23 (m) shall be, in the case of coal mines, 5 per centum, in the case of metal mines, 15 per centum, and, in the case of sulphur mines or deposits, 23 per centum, of the gross income from the

property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property. A taxpayer making his first return under this title in respect of a property shall state whether he elects to have the depletion allowance for such property for the taxable year for which the return is made computed with or without regard to percentage depletion, and the depletion allowance in respect of such property for such year shall be computed according to the election thus made. If the taxpayer fails to make such statement in the return, the depletion allowance for such property for such year shall be computed without reference to percentage depletion. The method, determined as above, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section. The above right of election shall be subject to the qualification that this paragraph shall, for the purpose of determining whether the method of computing the depletion allowance follows the property, be considered a continuation of section 114 (b) (4) of the Revenue Act of 1934, and as giving no new election in cases where such section would, if applied, give no new election.

The provisions of Sections 114 (b) (1) and (4) of the Revenue Act of 1938, c. 289, 52 Stat. 447, and the Internal Revenue Code are identical with those of the corresponding section of the 1936 Act.

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

> ART. 23 (m)–5. *Computation of depletion based on a percentage of income in the case of coal mines, metal mines, and sulphur mines or deposits.* * * *
>
> In his first return made under Title I of the Act (for a taxable year beginning after December 31, 1933) the taxpayer must state as to each property with respect to which the taxpayer has any item of income or deduction whether he elects to have the depletion allowance for each such property for the taxable year computed with or without reference to percentage depletion. An election once exercised under section 114 (b) (4) and this article cannot thereafter be changed by the taxpayer, and the depletion allowance in respect of each such property will for all succeeding taxable years be computed in accordance with the election so made. If the taxpayer fails to make such statement in the return in which the election should be so indicated, the depletion allowance for the year for which an election must be first exercised and for all succeeding taxable years will be computed without reference to percentage depletion. The method, determined under section 114 (b) (4) and this article, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer,

or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section.

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (m)–5. *Computation of depletion based on a percentage of income in the case of coal mines, metal mines, and sulphur mines or deposits.*—* * *

Subject to the qualification specified in the last sentence of this paragraph, a taxpayer making his first return under Title I of the Act (for a taxable year beginning after December 31, 1935) in respect of a property must state as to each such property whether he elects to have the depletion allowance for each such property for the taxable year computed with or without reference to percentage depletion. For the purpose of this article the taxpayer's first return under Title I of the Act in respect of a property is the return made under that title for his first taxable year (beginning after December 31, 1935) for which he has any item of income or deduction with respect to such property. An election once exercised under section 114 (b) (4) and this article can not thereafter be changed by the taxpayer, and the depletion allowance in respect of each such property will for all succeeding taxable years be computed in accordance with the election so made. If the taxapayer fails to make such statement in the return in which the elec-

tion should be so indicated, the depletion allowance for the year for which an election must be first exercised and for all succeeding taxable years will be computed without reference to percentage depletion. The method, determined under section 114 (b) (4) and this article, of computing the depletion allowance shall be applied in the case of the property for all taxable years in which it is in the hands of such taxpayer, or of any other person if the basis of the property (for determining gain) in his hands is, under section 113, determined by reference to the basis in the hands of such taxpayer, either directly or through one or more substituted bases, as defined in that section. The right of election specified in this paragraph is subject to the qualification that section 114 (b) (4) shall, for the purpose of determining whether the method of computing the depletion allowance follows the property, be considered a continuance of section 114 (b) (4) of the Revenue Act of 1934, and as giving no new election in cases where such section would if applied, give no new election.

The provisions of article 23 (m)–5 of Treasury Regulations 101, promulgated under the Revenue Act of 1938, and Section 19.23 (m)–5 of Treasury Regulations 103, promulgated under the Internal Revenue Code, are substantially the same as those contained in Article 23 (m)–5 relating to the 1936 act.

U. S. GOVERNMENT PRINTING OFFICE: 1944